

IN THE
SUPREME COURT OF MISSOURI

No. SC87146

EMERSON ELECTRIC CO.,

Appellant,

v.

DIRECTOR OF REVENUE,

Respondent.

Petition For Review
From The Administrative Hearing Commission,
The Honorable Karen A. Winn, Commissioner

RESPONDENT'S BRIEF

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STATEMENT OF FACTS

This appeal arises from an attempt by appellant Emerson Electric Co. to invoke the “manufacturing” exemption to sales and use tax for its purchase of three pieces of equipment — a stereolithography machine, a computer-assisted design (“CAD”) system, and a dynamometer — used in the development of new products.

Emerson is a Missouri corporation headquartered in St. Louis. ¶¶ 1, 2.¹ Among its manufacturing plants is one in Kennett, Missouri. ¶ 3. During the tax periods in question Emerson also a plant in Ava, Missouri. *Id.* But the equipment at issue here was not purchased for use in either Kennett or Ava.

The equipment was instead purchased for use and installed in an Emerson research and development facility, the Motor Technology Center (“MTC”), located at on Emerson’s St. Louis campus. ¶¶ 4, 58. As the Administrative Hearing Commission found, “The MTC is one of three Emerson Advanced Technology Centers that serve as a research and development network for the company's global operations. The Advanced Technology Centers provide Emerson divisions with

¹ References to numbered paragraphs are references to the Administrative Hearing Commission’s findings of fact. The Commission’s decision appears in the Legal File beginning at p. 148, and in the Appellant’s Appendix beginning at p. A1.

access to expertise, information resources, and ongoing research in emerging technologies.” ¶ 5. The “common goal” of the MTC and Emerson’s two other Advance Technology Centers “is to identify opportunities for breakthrough products and systems that Emerson can use in developing future-generation products and services.” ¶ 7.

The specific mission of the MTC “is to find ways to continuously improve Emerson’s motors by making them quieter, smaller, more efficient, and longer lasting.” ¶ 8. The MTC “develops new electric motors” and “supports Emerson companies and their customers in developing advanced motors and electronic controls.” ¶ 11. Within its 15 laboratories, the MTC “contains CAD [computer-assisted design] equipment, measurement equipment, a materials lab for evaluating various materials, motor test facilities, and sound laboratories.” ¶¶ 11, 15. It also has windows and placards used for tours, enabling Emerson to use the MTC as a marketing tool. ¶ 13.

Emerson develops both “platforms” of motors – a generic motor style designed to meet a general application, such as a swimming pool motor or an air conditioner motor (¶ 22) – and specific motors, some based on platforms already in existence and some developed independent of existing platforms. ¶¶ 16, 21.

When Emerson develops a new motor – either on its own or in cooperation with a customer – it must do “a lot of sampling and testing.” ¶¶ 17, 18. Emerson creates prototypes and sample motors, which it supplies to customers “for use in the customer’s prototype application, typically to determine fit, form, and function.” ¶ 25.

The Administrative Hearing Commission described the creation and use of sample motors – and their relation to actual production motors sold to customers for ultimate consumer use:

41. Emerson makes some parts for samples with a stereolithography machine The plants are also involved in making parts for samples, and Emerson's engineers go to the plants to assist in making the samples.

42. After the sample is designed and produced, it must be tested. Emerson runs many tests in the MTC. Emerson runs tests with a dynamometer ... and it also tests the motor in its application to make sure it works properly under various voltages and within the temperature limits of Underwriters Laboratory (“UL”).

43. After the final sample is approved, the MTC's application engineering group creates documents of all the drawings and materials for

the motor. The MTC allows the plants to have access to the production bill materials and drawings so the plants will know how to build the motors.

44. Emerson produces more sample motors for a pilot run. This is sometimes a few motors or can be as many as 200 motors. Emerson builds the sample motors at its plants, and the application engineers from the MTC go to the plants to assist in building the sample motors. Emerson brings the sample motors to the customer to make sure that the customer approves of them. ...

Only when the customer has approved the sample motors does “Emerson provide[] the customer with a quote of the price at which Emerson may sell the motor to the customer.” ¶ 45. Only when the development process is complete does Emerson “order[] tooling to make the item a mass production item.” *Id.*

This case involves three machines acquired by Emerson – again, each installed and used at the MTC, not at Emerson’s manufacturing plants.

The first is a stereolithography machine that Emerson purchased in April 1995. ¶ 59. Emerson bought the machine “to provide research and development (‘R&D’) stereolithography part service to Emerson Motor and other Emerson divisions”– in particular “to increase the production of sample parts” and “to provide rapid prototyping technology.” ¶ 60. The Commission explained what

the machine does: “The stereolithography machines allow inexpensive experimentation of new part designs and manufacturing processes. ... The stereolithography machine uses a laser and liquid polymer to make three-dimensional molded plastic samples without any tooling” ¶ 61. Without the machine, “in many cases Emerson was not able to make a sample part.” *Id.* But the machine makes only plastic sample parts. “The plastic parts may be used in mechanical testing or to see how parts will fit in an application, though they may not be strong enough to be used in performance testing. ... The sample parts are not working models and are not suitable for use in a real machine.” ¶ 63.

The second is a dynamometer, which “Emerson uses . . . for development purposes as well as to test sample motors.” ¶ 69. Emerson tests sample motors to ensure that they meet standards set by the industry, through the National Electric Machine Association (“NEMA”), by the U.S. Department of Energy, and by customers. ¶ 70, 71. Emerson purchased the dynamometer and related equipment between May 1995 and July 1996. ¶ 74.

The dynamometer is not used exclusively on sample motors. Sometimes it is used for “the calibration and validation of dynamometers in the plants to assure that they are meeting efficiency levels.” ¶ 72. And occasionally it is used for

quality control. In that instance, Emerson pulls a motor from the manufacturing plant, brings it to the MTC, and tests it. *Id.*

The third item is a Pro/Engineer (“Pro/E”) computer-assisted design (“CAD”) system, consisting of both hardware and software, purchased in various steps in January and February 1998. ¶ 77. Emerson bought the system to “accelerat[e] new product development, improve[] engineering and product quality, and increase[] engineering productivity. ¶ 80. It is used mostly to design new motors based on existing platforms, but also to develop new platforms and to create new designs jointly with potential customers. ¶ 83.

When the Director audited Emerson’s purchases, she concluded that the MTC is a research and design facility, not a manufacturing facility. ¶ 84.

Emerson filed two refund claims in June 2002. ¶ 86. One covered identified purchases for April 1994 through April 1997. ¶ 86. The other covered April 1994 through June 1998. ¶ 87. The second claim asserted that the items purchased qualified under the “manufacturing” exemption. *Id.*

The Director denied the first claim on July 18, 2002, finding that it was untimely – *i.e.*, that it was not filed within three years of the date of payment. ¶ 88. On December 13, 2002, the Director assessed sales tax for August 1994 through October 1996, and use tax from second quarter 1994 through first quarter 1997.

¶ 89. On December 30, 2002, the Director assessed sales tax for April 1996.

¶ 89. And on May 20, 2003, the Director denied the refund claim for April 1994 through June 1998 because the items were used in research and development, not to manufacture products to be sold. ¶ 90.

Emerson paid \$8,510.34 in use tax on its purchase of the stereolithography machine, and \$1,367.54 in use tax on its purchase of the CAD system. ¶ 91. The Director assessed \$25,521.79 in use tax on Emerson's purchase of the components of the dynamometer. ¶ 92.

On September 18, 2002, Emerson filed a petition with the Administrative Hearing Commission, seeking review of the Director's denial of the April 1994 – April 1997 refunds. On February 11, 2003, Emerson appealed the Director's tax assessments. And on July 7, 2003, Emerson appealed the Director's denial of the refund claim for April 1994 – April 1998. The Commission consolidated the three cases.

On September 7, 2005, the Commission affirmed the Director's decisions as to the stereolithography machine, dynamometer, and CAD system. L.F. 148-183.

ARGUMENT

There is no dispute as to the facts. Emerson installed and uses the three items it purchased in the MTC. And Emerson uses them to create designs, prototypes, and samples – *not* to create motors that are sold to customers for ultimate use. The “manufacturing” exemption simply does not cover such research and development functions, despite the obvious fact that every manufactured product must at some time have been designed.

1. The Statute and the Rule of Construction.

Emerson Electric invokes the sales tax exemption for machines and equipment used to “manufacture” goods that are ultimately sold for consumption or use – sales that presumably are themselves taxable. Emerson’s claim poses the question of whether or how that exemption applies to research and development of a products that are then manufactured.

No Missouri appellate court has addressed that question in the context of the statute Emerson invokes. But the Missouri Court of Appeals, Southern District, did address that question in a different revenue context in *Mid-America Dairymen, Inc. v. Payne*, 990 S.W.2d 648 (Mo. Ct. App. S.D. 1999). There, the court of appeals distinguished between design and manufacture, though with little discussion. That court did, however, cite and rely on a rule of construction that

applies equally here: the rule that tax exemptions – such as the one there and the largely parallel one here – are construed against the taxpayer. *Id.* at 651, quoting *Trailer Corp. v. Director of Revenue*, 783 S.W.2d 917, 920 (Mo. banc 1990). *See also Cook Tractor v. Director of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006).

The manufacturing exemption that Emerson invokes is found in § 144.030. It applies only to certain items.

As it is pertinent here, the statute first identifies the kind of goods to which it applies: “Machinery and equipment.” Here, there is no question that the items Emerson purchased constitute “machinery” or “equipment.” So the analysis in this case, as in *Southwestern Bell Telephone Co. v. Director of Revenue*, 182 S.W.3d 226 (Mo. banc 2005) (*SW Bell II*) and its predecessors, moves immediately to the second part.

The exemption does not apply to the purchase of all machinery or equipment; it applies only to machinery and equipment that is used in a certain way:

2. There are also specifically exempted from the provisions of the ... sales [and use] tax law ...

(5) Machinery and equipment . . . used directly in manufacturing . . . a product which is intended to be sold ultimately for final use or consumption

144.030. The pertinent phrase after “machinery and equipment” is “used directly in manufacturing” – the phrase whose meaning and application was at issue in *SW Bell II*. But in *SW Bell II* the Court could go immediately to that question only because it had already considered other, preliminary ones. Most notably, it had already identified the “product” being manufactured, in *Southwestern Bell Telephone Co. v. Director of Revenue*, 78 S.W.3d 763, 766-67 (Mo. banc 2002) (*SW Bell I*). That is an essential prerequisite to determining whether a given piece of equipment is “used directly” in manufacturing; it is literally impossible to determine whether a particular machine is “used directly in manufacturing” a qualifying product until we know what that product is.

2. The Products.

Emerson makes electric motors. But for purposes of determining whether the manufacturing exemption applies, the court must distinguish between two types of motors. The first are “sample” (sometimes called “prototype”) motors. These may be unique motors – the first experimental motor of a particular design. Or they may be motors built for a “pilot run” – and Emerson sometimes produces as

many as 200 sample motors for a “pilot run.” ¶ 43. Regardless, these are motors that are made *before* manufacturing begins. They are made not to sell to customers, but to persuade customers to contract for the manufacture of something else: production motors – motors that are made on an assembly line in enough quantity to supply a customer’s needs.

Of course, in the process of making prototype or sample motors, Emerson makes drawings, models, even plastic versions of motors or motor parts. None of these items are motors, of course. And Emerson does not sell them to customers. Emerson does not even quote a price for production motors, much less tool a factory to manufacture them, until the customer has approved sample motors. ¶ 45.

3. *The Sales.*

Once the court determines what “products” Emerson is manufacturing, it must determine which of those products are “intended to be sold ultimately for final use or consumption.” That limitation is consistent with the theory of this and other sales and use tax exemptions: to encourage industry in Missouri by deferring sales tax until the point at which a consumer purchases or uses a particular item. In general, the sale of a product “for final use or consumption” will be taxable. When one of Emerson’s customer’s buys an Emerson motor and incorporates it into a washing machine or automobile, the ultimate consumer – the person who buys the

washer and takes it home or drives the car off the lot – will pay sales tax. The exemption prevents the State from taxing the sale of the motor and then taxing the sale of the item incorporating the motor. The exemption is limited to those “products” that are intended for sale, *i.e.*, items where the State can expect to collect sales or use tax further downstream.

Emerson intends that its production motors will be used by customers to create products for sale to consumers — *i.e.*, for taxable sales. So machinery and equipment that is “used directly to manufacture” production motors would qualify for the exemption.

But the same cannot be said for the designs, prototypes, and sample motors that Emerson creates using the equipment whose purchase is at issue here. As the Commission found, “Emerson’s customers do not purchase the prototype motors, and Emerson does not produce invoices for the prototype motors. Therefore, the prototype motors are not products intended to be sold ultimately for final use or consumption.” L.F. at 173.

The same is certainly true for the “three-dimensional molded plastic samples” that Emerson makes using the stereolithography machine. Although they may help Emerson market motors by enabling customers to check how the motors would fit into the customer’s finished products, nothing in the record suggests that

Emerson sold, or ever intended or even hoped to sell, those samples for final use or consumption. Indeed, the record does not support the inference, much less defeat the Commission's contrary finding, that the samples and prototypes are themselves suitable for sale or ultimate use.

The same is true for CAD designs. Emerson cites nothing in the record to show that customers buy those designs. What they buy are production motors made according to those designs.

4. Use in Manufacturing.

Emerson simply cannot claim that designs, prototypes, and samples are themselves “intended to be sold ultimately for final use or consumption.” So Emerson claims that creation of designs, prototypes, and samples is part of manufacturing the ultimate product. *See* Appellant's Brief at 24. To do so, Emerson makes four arguments relating to the actions performed by the machines and their connection with the products Emerson actually sells – and adds a gloss regarding the involvement of customers.

Integrated Plant Doctrine

First, Emerson cites the “integrated plant doctrine,” and asserts that the MTC is part of its “integrated plant. That argument is misplaced; even machinery used in an “integrated plant” must be used in some way to manufacture products

“intended to be sold ultimately for final use or consumption,” not just to create designs, prototypes, or samples. Emerson largely skips that part of the analysis, jumping to what it describes as this Court’s “longstanding” rule that “allows the manufacturing exemption for items that are used before the actual transformation of raw materials into a finished product begins, and for items that are in a different location from the manufacturer’s product line.” App. Br. at 30. But none of the precedents Emerson cites go nearly as far as Emerson’s claim requires.

This Court first adopted and applied the “integrated plant” doctrine in a pair of cases decided by different divisions of the Court on the same day: *Floyd Charcoal Co., Inc. v. Director of Revenue*, 599 S.W.2d 173 (Mo. 1980), and *Noranda Aluminum, Inc. v. Missouri Department of Revenue*, 599 S.W.2d 1 (Mo. 1980). The Court found that doctrine in *Niagara Mohawk Power Co. v. Wanamaker*, 144 N.Y.S.2d 458 (App. Div. 1955), where the New York court decried as “not practical” the approach of dividing a single “generating plant” (there, an electrical generating plant) “into ‘distinct’ stages.” 144 N.Y.S.2d at 461-62, quoted in *Floyd Charcoal* at 599 S.W.2d at 177. The New York court did not give the “integrated plant” precise boundaries. Instead, it eschewed the use of any “simple test” and endorsed use of the three questions: “(1) Is the disputed item necessary to production? (2) How close, physically and causally, is the disputed

item to the finished product? (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?” 144 N.Y.S.2d at 461, quoted in *Floyd Charcoal* at 599 S.W.2d at 177, and in *SW Bell II*, 182 S.W.3d at 230.

The three “integrated plant” criteria lead to the conclusion that the MTC equipment is not “used directly” in manufacturing. Though perhaps that equipment is necessary to design and marketing, it is not necessary to the actual production of the products Emerson sold. It is not close, “physically or causally,” to the production motors. It is at a remote location, and is used before production can begin. It is used separately from, not “harmoniously” with, production equipment. It is, quite simply, in no way an “integrated” part of any manufacturing plant. The application of the doctrine from *Floyd Charcoal* through *SW Bell II* does not suggest otherwise.

In *Floyd Charcoal*, the equipment and materials were used at the site of a single plant, between the point at which the raw materials were gathered on site and the point at which the saleable product was complete. The Court considered the application of the “manufacturing” exemption to various pieces of equipment, including: the “Sackmatic System and Filter,” “used to sack the finished charcoal product”; the “Sewing Heads,” “used to sew the sack closed at the top after

briquettes have been put into the sack”; the “check weight and panel,” “used to weigh the sack after the charcoal has been put into it”; and the “film bags,” used “to enclose the original paper sacks which contain the charcoal . . . to protect the charcoal from moisture during transportation.” *Id.* at 175. The Court held, without further explanation, that “the equipment involved in weighing and sacking” was an “integral part of the . . . manufacturing process.” *Id.* at 178. But the Court summarily rejected the claim that the “film bags” were exempt, because nothing in the record showed that they were actually used in manufacturing, even though they were used within the Floyd Charcoal plant. *Id.* at 179.

In *Noranda Aluminum*, the Court addressed, most pertinent here, equipment used in an on-site laboratory – “equipment designed for chemical and physical analysis of aluminum metal and to monitor the efficiency of the reduction process.” *Id.* The Court found that the laboratory work was “essential to and a part of the manufacturing process” because the results of laboratory testing were necessary to “determine if there are impurities getting into the aluminum” and were “used to direct the molten aluminum into further fabricating.” *Id.* at 4. Samples were taken “[e]ach day” from “each crucible” and “immediately analyzed” in order to “direct the crucibles,” whose chemistry may vary slightly, “into the most

finishable fabrication given the products” that can be produced with the contents of that particular crucible. *Id.*

Nothing in *Floyd Charcoal* or *Noranda* provides support to Emerson. Again, in each case the machinery was used on the site of a single plant. In each, it was used between the point at which the raw materials for a particular product were gathered and the saleable product was completed. The machinery was not used to design charcoal or aluminum, nor to create prototypes or samples.

The Court returned to the “‘integrated plant doctrine’, viewing manufacturing operations as ‘continuous and indivisible,’” in *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186, 191 (Mo. banc 1996), quoting *Floyd Charcoal*, 599 S.W.2d at 178. The Court held that a single “plant” can have diverse locations – *i.e.*, the Court ruled that “physical distance alone is not determinative,” but it still required a “direct tie” between the two manufacturing functions. *Id.* at 192-93.

The facts in *Concord Publishing* are far removed from those presented by Emerson. There, the equipment was used for “composition and editing” of actual newspapers printed for sale, not to design newspapers, nor to create prototypes or samples. There is nothing in *Concord Publishing* to suggest that the “integrated plant” extended beyond the machinery, equipment, or supplies used to process the

raw materials – paper, ink, and information – that became part of the newspapers actually sold to the public. Moreover, there is no “direct tie” between the manufacturing process in plants in Ava and elsewhere and the equipment located in the MTC — not even a twisted pair or fiberoptic cable like these used by Southwestern Bell.

Nor can Emerson find support in *DST Systems, Inc. v. Director of Revenue*, 43 S.W.3d 799 (Mo. banc 2001). There, the Court again applied the “integrated plant doctrine” to manufacturing that involved the processing of information, this time to the creation of financial reports. The computers at the location in dispute were used to “gather, store and organize all the information” that was then printed and distributed. *Id.* at 803. In other words, the “mainframe computers” at one location “r[a]n the software applications that enable[d] the printing of products” at the other location. *Id.* The Court reiterated that the “integrated plant” could include operations at different locations – but only so long as “the equipment and machinery of the two entities are ‘integrated and synchronized’ for the purpose of manufacturing a product intended to be sold ultimately for final use or consumption.” *Id.*, quoting *Concord Publishing*, 916 S.W.2d at 192.

Emerson’s equipment is not “integrated and synchronized” with the equipment used in manufacturing. In fact, its use is complete before Emerson even

knows whether it will actually manufacture production motors. Although Emerson's product design may be based on information acquired using or shown in documents created by the MST equipment, the information itself is not part of the product in the sense the Court allowed in *DST* and *Concord Publishing*.

The Court most recently returned to the "integrated plant doctrine" in the *SW Bell* cases. There, the Court held that a telephone system qualifies as an "integrated plant." But the description of the system stands in stark contrast to Emerson's situation: "[T]he entire system operates continuously along pathways formed by much of the equipment at issue" 182 S.W.2d at 233. The MST equipment is not part of a "continuous" manufacturing operation. It is used in a separate, albeit related, process: the design and marketing of the product to later be manufactured.

When Emerson claims that this Court's precedents "allow[] the manufacturing exemption for items that are used before the actual transformation of raw materials into a finished product begins" (App. Br. at 30), it suggests that many of the precedents involve such items. But the only case that expressly includes pre-manufacturing equipment (as opposed to equipment used in the early stages of manufacture, such as the laptops in *Concord Publishing*) is *Floyd Charcoal*, and the only equipment in *Floyd Charcoal* that fits that description is

the “starch system.” But the “starch system” was located at the plant site, was used to hold material that is incorporated into the product that is finally sold, and was essential to the “continuous flow process” used in the plant. *See* 599 S.W.2d at 177. There is a huge difference between use of machinery to feed into the continuous process of manufacturing charcoal briquettes and the use of machinery to create designs, prototypes, and samples from which a manufacturing process may ultimately result.

Again, no “integrated plant” precedent extends the “plant” nearly as far as Emerson wishes. The Court should refuse Emerson’s invitation to erase all boundaries on “integrated plants.”

Design and Testing

As noted above, the purpose of the “integrated plant doctrine” is to relieve the courts from parsing through equipment that is used in a single plant to determine which equipment is “used directly” in manufacturing and which equipment is not. But Emerson suggests an alternative theory that avoids the need to worry about the scope of the “integrated plant doctrine”: that research and development is itself part of manufacturing. In Emerson’s view, because design and testing necessarily precede manufacturing, design and testing are part of manufacturing. *See* App. Br. at 30-31. But Emerson is unable to find a single

authority for erasing the line applied in *Mid-American Dairymen* and enlarging the definition of “manufacturing.” Indeed, Emerson’s own language implies a design/manufacturing distinction.

For example, Emerson says that the CAD system creates drawings that “tell employees at the plant ‘how to build the motors’ and thus guide the entire production process.” App. Br. At 31-32, quoting Tr. 72. The “production process” may be “guided “ by the design, but the design is not itself part of the process.

More blatant is Emerson’s description of how it uses the SLA machine: *i.e.*, to creates “plastic parts to test and to determine whether the design ... will actually work and fit where it is needed in the customer’s application.” App. Br. at 32. Use of those plastic parts is complete before a single motor is manufactured to be sold to the customer.

Emerson does manage to find an occasional connection between the dynamometer and production of motors for sale. The principal uses of the dynamometer are “to certify ... efficiency levels,” “measure performance parameters,” and “to refine designs and address design problems.” App. Br. at 33. Emerson concedes that the “Commission found that only testing motors in mass production at Emerson’s plants and calibrating test equipment were part of manufacturing.” App. Br. at 33. Those functions are similar to the functions

performed by the laboratory in *Noranda* – albeit at a remote location, not within the plant as at Noranda. But as the Commission found, such use of the dynamometer was incidental. L.F. 182. The Commission properly drew a distinction between creation and testing of prototypes and sample motors and the manufacture of motors for sale. *Id.*

The creation, perfection, and marketing of motor designs is simply not part of the “continuous flow” of manufacturing; it necessarily precedes that “flow.” Emerson argues to the contrary by reference to the facts in *Concord Publishing and Floyd Charcoal*. “[R]ecording information on a laptop is essential to the production of a newspaper” (App. Br. at 35) because the product being manufactured is a combination of ink, paper, and that information. But under Emerson’s theory, if Concord Publishing developed new typefaces for greater legibility of newspapers, that would be part of the manufacturing process – even if most of the typefaces so developed are never used on newspapers actually sold. “[P]ositioning starch is essential to making briquettes” (*id.*) because the starch holds the briquettes together. But under Emerson’s theory, not just Floyd Charcoal’s starch delivery system, but the research and testing to decide on the best type of and source for starch – maybe even the equipment used in negotiating for, buying, and delivering the starch – are part of the manufacturing that uses the

starch. Emerson proposes *no* limits: anything that may contribute to a product ultimately offered for sale will fit within Emerson’s view of the “manufacturing” exemption.

Certainly there is no suggestion in the statute that the legislature shared Emerson’s expansive vision of “manufacturing.” If it had, there would have been no need for the exemption for “research and development of prescription pharmaceuticals” (ultimately, like Emerson’s motors, products “intended to be sold ultimately for final use or consumption”) in § 144.030.2(33). And perhaps no need for the exemption for “research and experimentation activities performed by life sciences companies,” found in § 144.030.2(37) (using a definition provided in § 144.010.1(8)). Those provisions show that the legislature understands how to bring research and development within the scope of a sales tax exemption – and in the case of manufacturing, has so far chosen not to do so.

Director’s Regulation

Emerson next claims that two examples of “manufacturing” given in the Director’s own regulations support its claim: testing equipment used “(i) to ensure that the seller’s product meets the tolerances claimed in its marketing literature,” and “(ii) to meet the customer’s specification requirements mandated by the sales agreement.” 12 CSR 10-111.010(4)(F). Such equipment is akin to the laboratory

equipment in *Noranda*. That it does not include the machinery here should be apparent for two reasons. First, both examples contemplate that the product is already in production – *e.g.*, there is already “marketing literature” or a “sales agreement” that details the specifications. More important is the contrast between those examples and the third example in the same section: testing equipment used “iii) to perform research and development on potential new products.” *Id.* By saying that the third example is *not* manufacturing, the Director excludes pre-production design and testing. *Id.* Her third example – into which Emerson’s MTC equipment fits squarely – does not overlap with, but instead gives a limited meaning to, the first two.

The distinction between development and manufacturing is consistent with Emerson’s own practice. Emerson creates designs, prototypes, and sample motors – *i.e.*, it does research and development – *before* it ever enters into a sales agreement with a customer. *See* ¶ 45. It does so at a different location using different personnel. Emerson’s research and development and its manufacturing may be linked, but they are not a single, continuous process.

“True Object” Test

Emerson next combines a footnote reference to “design charges” from *Concord Publishing* with another regulation in an attempt to draw this case into the family of those in which services are provided as part of the sale of tangible personal property. But neither *Concord Publishing*, nor the regulation, nor logic support Emerson’s invocation of the “true object” test.

The *Concord Publishing* footnote addressing “design charges” (916 S.W.2d at 191 n. 6) is, of course, dicta; there is nothing in the footnote suggesting that “design charges” were at issue in the case. And it confirms that what was at issue was “the full process of producing a newspaper” (*id.*) – *not* the process of creating the designs, prototypes, and samples to offer to customers to show what the newspaper, if later produced, might be like. Thus the footnote, referencing the Director’s regulations, speaks of “copy or artwork that may be included in the final charge” – presumably, copy and artwork that are in the issue that the customer ultimately buys on the newsstand, not copy and artwork that are created as templates or examples in an effort to demonstrate what a newspaper, using new technology perhaps, might finally look like.

Emerson then turns to 12 CSR 10-103.600, which addresses sales in which the “tangible personal property and a nontaxable service are not separable.”

Though Emerson cites two of the Director's examples, Emerson makes no attempt to explain how the purchase of one of its electric motors is anything like the sales the Director describes. Indeed, in Emerson's view such an attempt is irrelevant: in that view, design and engineering services are necessarily part of the price paid for any motor – or, to extend Emerson's logic, for any manufactured good.

That is true, in a sense; presumably nearly all manufacturers indirectly build research and development costs into the prices of their final products. But it carries the “true object” test well beyond the context in which it was developed, *i.e.*, where there is a need to determinate what portion of a price paid is for taxable goods and what portion is for accompanying nontaxable services. The logical problem with Emerson's claim is that ultimately, Emerson's customer cares only about the production motors. If their fit and function is as advertised, Emerson's customer really doesn't care how they were designed. Though customers may get involved in developing motors, their object is merely to ensure the suitability of the ultimate product. If they could do as well with something Emerson already had “on the shelf,” they would take that – as it is likely faster and cheaper to acquire a motor that is already in production than to await the design, testing, and eventually the production of a new model. The “true object” test is simply inapposite here.

5. Customer Involvement

In making many of its arguments, Emerson points out that in some instances, Emerson's engineers work with a customer to design a particular motor. Emerson cites nothing – neither statute, nor precedent, nor event logic – to support its claim that the customer's involvement makes a difference in determining when manufacturing begins and what it includes. The involvement of the customer is a marketing issue – though Emerson could and does develop motors without involving customers, involving customers increases the possibility that the motors will eventually be manufactured. It is not sufficient, however, under the statute for the machinery to be used to enhance marketability. It must be “used directly in manufacturing . . . a product which is intended to be sold ultimately for final use or consumption.”

The principle underlying this Court's holding that “manufacturing” of a single product can involve multiple companies (*see SW Bell II*, 182 S.W.3d at 233) is that “manufacturing” must be given a functional meaning. The function remains “manufacturing” regardless of how many persons or companies are involved. The converse must also be true: research, development, and other steps do not become part of “manufacturing” because the ultimate customer is on the scene. The Court should not erase the obvious functional distinction between the process of

manufacturing and the process of designing the item to be manufactured merely because a potential customer is involved at an early stage.

CONCLUSION

Construed against Emerson, as the applicable rule of construction requires (*see* p. 11-12, *supra*), the manufacturing exemption cannot be read to cover the development of products that are later manufactured. Thus Emerson cannot invoke the exemption for the three items in the MTC, and the Court should affirm the decision of the Administrative Hearing Commission.

Respectfully submitted,

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Certification of Service and of Compliance with Rule 84.06(b) and (c)

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 6,044 words.

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